

Testimony of Bill Knox
Bank of Whitman, Colfax WA
FCA Public Hearing on OFIs & FCS Relationships
August, 3rd, 2001

Good morning, it's a pleasure to be here. I'm Bill Knox from the Bank of Whitman in Colfax, Washington. I am in charge of running our bank's OFI.

Our bank has approximately \$160 million in assets and about one-half of our loans are agricultural loans. We are continually exploring funding options so we can meet the loan demands of our customer base. We use the Federal Home Loan Bank, Farmer Mac and we have an OFI which we started in 1997.

We've put a lot of effort into our OFI relationship and we believe we are getting to the place where our OFI is functioning fairly smoothly. But that is not to say that establishing an OFI is an easy or simple process. So it's understandable why the program isn't utilized more in its current format. But that is not to say that it couldn't be better utilized if more changes were made. Being more consistent with the FHLB format would be one way to accomplish this as is evidenced by the thousands of banks who are FHLB members. Certainly the funding needs and liquidity concerns of ag bankers will grow in the future and we should modernize the OFI program to keep up with these challenges.

My suggestions would be along the following lines.

- **Make Program Easier to Utilize:**

- 1) *Standardized Application Form* - FCA could begin by developing a simple standardized application form. OFIs generally complain about too many regulatory hoops and too much paperwork burden;
- 2) *Office of OFI Supervision* - FCA should also establish a separate "Office of OFI Supervision" within FCA. This office would have responsibility for assisting OFIs with the application process and marketing the program to potential users, be they a group of farmers who want to start up a small cooperative tied to an OFI to access credit, or a bank OFI. This office should include a high level senior staff person designated as the "OFI Ombudsman" to help OFIs deal with any issues that may arise. Simply leaving the results of the OFI program to examiners as part of their overall examinations process once every 18 months, does not allow for the necessary promotion and monitoring of this program;
- 3) *Cross District Funding* - Allow commercial bank OFIs to apply for membership with the district Farm Credit funding bank of their choosing. This will diminish competition concerns from FCS associations who may be funded by the same FCS funding bank, making the funding bank's relationship with the OFI less stressful and objectionable to associations.

- **Provide Equal Rates to OFIs as to FCS Associations**

- 1) *Eliminate/Minimize Capital Equalization Factor & Other Fees* - District FCS banks should not be allowed to charge big fees, such as “capital equalization factors”, that can range up to 150 basis points. Obviously this makes the cost of funds (COF) for OFIs prohibitive since this rate is in addition to the discount rate offered to the PCAs and the ACAs. These fees are not necessary to capitalize the funding bank.
- 2) *Risk Weighting* - The FCA’s ANPRM last year outlined the current situation in which district FCS banks are required to hold five times more capital for OFIs than FCS associations. In other words, loans to OFIs are required to be risk-weighted at 100 percent but loans to FCS associations are risk weighted at only 20 percent. We believe that commercial bank OFIs should have the same exact risk weighting as FCS associations – 20 percent. Otherwise it is a disincentive for district FCS banks to lend to OFIs since they must maintain more capital. This is likely also reflected in a higher cost of funds to OFIs.

However, let me stress that requiring risk weighting on an individual loan or individual institution basis – for commercial bank OFIs – is totally inappropriate given the extensive risk mitigation controls that commercial banks pursue

- 3) *Publish Weekly Rate Sheets* – The “Office of OFI Supervision” should also be charged with publishing weekly rate sheets. For example, Farmer Mac has in the past, released rates for its programs on a regular basis. These sheets should describe the rates for various term loans being offered by FCS district funding banks to OFIs and FCS associations. Otherwise there is no way for the FCA to determine if the rates being provided are indeed “comparable”. The rate sheets to OFIs should also include cost of funds (COF) data that has a breakdown of any fees charged by the district funding banks to OFIs, quantified in terms of actual basis points and/or percentage points.

OFI representation / Corporate Structure / Greater Cooperation

- 1) *Make OFI Members True Partners* - OFIs should have many of the same rights that FCS associations have in terms of acquiring stock and receiving dividends, access to products and services, attendance at annual meetings and at least one position on the board of directors of each district FCS bank. OFIs should be equal citizens in the FCS structure and not discriminated against in terms of pricing, representation or other opportunities. OFIs should have a voice in the System to which they are contributing and paying into.
- 2) *Value Added Loan Participations* – There is currently a great deal of interest in value added agriculture. For example, many cooperatives have been formed to pursue ethanol production. Community banks often help get these opportunities off the ground in terms of spreading the word to farmers and promoting the projects in their communities. However, they cannot finance the projects by themselves due to the large loan size.

- 3) *ACA & Optional Structures for OFIs* – Currently the OFIs are limited to only one structure, a separately capitalized entity distinct from its parent. This is not required in the statute. Consider allowing OFIs to apply based on whatever structure they deem most appropriate for the financial institution they are a part of. For example, consider allowing OFIs to organize as holding company Ag Credit Associations (ACA's), with the ability to do both short-term and long-term lending. And with the same tax benefits.

Conclusion

In conclusion, FCA should realize that there are currently more cost effective funding sources available to OFIs. That is why the OFI program has not attracted more participants. FCA needs to be willing to step in and provide some oversight and uniformity of the program to ensure it is successful and to ensure that OFIs receive equal access and rates to funding that FCS associations receive.

The FHLB model has been a proven success. Banker access to FHLB advances was expanded to include small business and agricultural loans. But this is still in its early stages and still being tested. Also, regulators frown when banks use a single alternative funding source too heavily, such as FHLB. And, in terms of alternative funding, bankers realize it is best not to have all of one's eggs in one basket. Therefore, it's appropriate that workable and improved access to a GSE specializing in agriculture be pursued, just as Congress has intended for many decades with the OFI statutes. Let's utilize the good aspects of the FHLB program to improve the OFI program.

Some impediments to the success of the OFI program may be due to limitations in the current statute. But let's begin improving the program by removing all regulations that are not called for by the statute. Let's have a modern, revamped program that we can all call a success. Gary mentioned ICBA's upcoming agricultural committee meeting. There may be additional ideas coming forward from this meeting which the ICBA would be happy to share with FCA.

The OFI program needs to be revamped with as few strings attached as possible and as few fees as possible so more OFIs can be formed to meet legitimate credit needs. Higher fees ultimately mean higher interest rates for farmers and less service to farmers. FCA should be proactive against the imposition of a fees on OFIs, which means ultimately better service to farmers. The reality is that the OFI program, under its current fee structure and unnecessary regulatory burdens, can not accommodate the present day needs banks would have in forming OFIs. We all have an interest in agriculture. Let's work to make the OFI a meaningful participant in serving agriculture's credit needs. **Thank you and I'd be happy to respond to any questions.**